

**PriceSmart, Inc. [PSMT]
First-Quarter 2023 Earnings Release Call
Tuesday, January 10, 2023 12:00 PM ET**

Company Participants:

Michael McCleary; Executive Vice President and Chief Financial Officer
Robert Price; Chairman of the Board

Analysts:

Jon Braatz; Kansas City Capital
Hector Maya; ScotiaBank

Presentation:

Operator: Good afternoon, everyone, and welcome to PriceSmart, Inc.'s earnings release conference call for the first quarter of fiscal year 2023, which ended on November 30, 2022.

After remarks from our company's representatives, Robert Price, Chairman, and Michael McCleary, Chief Financial Officer, you will be given an opportunity to ask questions as time permits.

As a reminder, this conference call is limited to one hour and is being recorded today, Tuesday, January 10, 2023. A digital replay will be available following the conclusion of today's conference call through January 17, 2023, by dialing 1-877-344-7529 for domestic callers or 1-412-317-0088 for international callers and by entering the replay access code 6032359.

For opening remarks, I would like to turn the call over to PriceSmart's Chief Financial Officer, Michael McCleary. Please proceed, sir.

Michael McCleary: Thank you, Operator, and welcome to the PriceSmart earnings call for the first quarter of fiscal year 2023 that ended on November 30, 2022. We will be discussing the information that we provided in our earnings press release and our 10-Q, which were both released yesterday afternoon, January 9, 2023. You can find these documents on our Investor Relations website at investors.pricemart.com, where you can also sign up for e-mail alerts.

As a reminder, all statements made on this conference call other than statements of historical fact are forward-looking statements concerning the Company's anticipated plans, revenues and related matters. Forward-looking statements include, but are not limited to, statements containing the words expect, believe, plan, will, may, should, estimate and some other expressions. All forward-looking statements are based on current expectations and assumptions as of today, January 10, 2023. These statements are subject to risks and uncertainties that could cause actual results to differ materially, including the risks detailed in the Company's most recent annual report on Form 10-K, the quarterly report filed on Form 10-Q yesterday and other filings with the SEC, which are accessible on the SEC's website at www.sec.gov. These risks may be updated from time to time. The Company undertakes no obligations to update forward-looking statements made during this call.

Now I will turn the call over to Robert Price, PriceSmart's Chairman of the Board.

Robert Price: Thank you, Michael. Hello, everyone, and welcome to our first-quarter-of-fiscal-2023 earnings call.

On behalf of myself and our Board of Directors, I would like to express our appreciation to Sherry Bahrambeygui for her leadership during the past 4 years. Sherry's performance as CEO during some of the most challenging years in the history of PriceSmart has been marked by record revenues and profits, as well as membership growth, club growth and the launch of online shopping. Our company is poised to build on Sherry's accomplishments. Sherry will remain on PriceSmart's Board of Directors, where she will continue to make important contributions to Price Smart's future success.

I am excited about reengaging more directly in our company's day-to-day business affairs. I have a very personal passion for PriceSmart. Our business takes place in countries that have significant economic and political challenges. Since our company's beginning in 1996, we have been committed to operating our business at the highest standards related to our buildings and equipment, our merchandise and, most importantly, to providing an outstanding working environment for our over 10,000 PriceSmart employees serving our members in the 12 countries and 1 US territory in which we do business. You, as PriceSmart's stockholders can be proud of the investment you have made in our company.

Now I will turn the call back over to Michael.

Michael McCleary: Thank you, Robert, and welcome again everyone to this call.

We had another outstanding first quarter, with both total revenues and net merchandise sales exceeding \$1 billion. Net merchandise sales increased by 8.6% after a negative 2.3% currency impact and comparable net merchandise sales increased by 5% after taking into account a negative 2.1% currency impact.

By segment, in Central America, where we had 27 clubs at quarter end, net merchandise sales increased 10.1%, with an 8% increase in comparable net merchandise sales. All of our markets in Central America had positive comparable net merchandise sales growth. In the Caribbean region, where we had 14 clubs at quarter end, total net merchandise sales increased 12.9% and comparable net merchandise sales increased 6.6%. All of our markets in this segment also had positive net merchandise sales growth.

In Colombia, where we had 9 clubs open at quarter end, net merchandise sales decreased 8.3% and comparable net merchandise sales decreased 13.1%. The decrease in Colombia during the current quarter was primarily due to the significant foreign currency devaluation that impacted net merchandise by 20.5% and comparable net merchandise sales by 19.6%. The comparable net merchandise sales decrease in Colombia contributed approximately 160 basis points of negative impact to total comparable net merchandise sales for the quarter.

In terms of merchandise categories, when comparing our first-quarter sales to the same period in the prior year, our foods category grew approximately 6%, our nonfoods category grew 1% and our other business category grew 10%, primarily from our food service and bakery departments.

Membership accounts grew 3.9% versus the prior year to 1.76 million accounts. We continued with strong 12-month renewal rates of 87.9% and our membership income was a record \$15.9 million, an increase of 7.5% over the same prior-year period. We believe that these membership numbers demonstrate that our members remain pleased with the value they are receiving and appreciate the PriceSmart shopping experience.

We remained diligent with inventory management, utilizing strategic markdowns to reduce slow-moving and excess inventory in the first quarter, primarily related to home furnishings and apparel. Total gross margins for the first quarter of fiscal year 2023 as a percentage of net merchandise sales increased 20 basis points to 16.2% versus 16% in the first quarter of fiscal year 2022. In total dollars, total gross

margin increased \$15.5 million, or approximately 10.3% versus the same quarter of the prior fiscal year. Total revenue margins increased 20 basis points to 17.6% of total revenue when compared to the same period last year, primarily due to the increase in merchandise gross margin.

The team has done a great job of being proactive about selling through overstocked categories. Our focus has been on getting back to our core business that has a more standard inventory balance and customary margin structure. We believe that good sell-through results in Q1, including for our Smart Week and World Cup events, are reducing the risk of additional markdowns in Q2. We have transitioned out of Christmas items and are now preparing for spring with water sports, camping and exercise programs that started landing in December and will bring fresh new merchandise to the clubs.

Supply chain disruptions were relatively tempered during this quarter, with our overall supply chain logistics network remaining relatively stable and reliable. Shutdowns in China lessened during the first quarter, but we remain cautious due to the recent Covid outbreaks there. We saw relief on shipping costs during the quarter on our trans-Pacific freight rates, which averaged approximately \$6,400 per container during Q1, down from \$11,500 last quarter, and rates approached \$4,000 per container at the end of November. Additionally, transit days for inbound containers loaded with our merchandise from Asia decreased to 51 days on average for the first quarter of fiscal 2023 from 61 in the fourth quarter of last year.

Unfortunately, inflation continues to be a macroeconomic factor that has a significant impact on the cost of our merchandise, driven in part by rising commodity input costs, labor and higher packaging costs. Although we do our best to mitigate cost increases, inflation has resulted in increases in our merchandise selling prices. For the first quarter of fiscal 2023 the average sales price per item increased 10.3% compared to the same period of the prior year. During the same comparative period, we've seen the items per basket decrease 4.4%. However, transactions grew 3% this quarter versus a year ago.

SG&A expenses decreased during the quarter by 40 basis points as a percentage of total revenue, primarily due to the sale of Aeropost and the devaluation of the Colombian peso. Operating income for the quarter increased 20.7% from the same period last year to \$55.5 million. Other expense of \$4.6 million was driven by \$3.2 million of foreign currency losses due to revaluation of monetary assets and liabilities in several of our markets. In addition, we had transaction costs of \$1.1 million associated with converting Trinidad dollars into available tradable currencies.

Our effective tax rate for the first quarter of fiscal 2023 came in lower than last year at 33.3% versus 34.1% a year ago. On a go-forward basis we estimate an annualized effective tax rate of 32 to 33%.

We are very proud of our results in this quarter, as our net income and earnings per share were a record for the Company. Net income for the first quarter of fiscal 2023 was \$32.9 million, or \$1.05 per diluted share, compared to \$30.5 million, or \$0.98 per diluted share, in the comparable prior-year period, which included a \$0.05 gain from the sale of Aeropost.

Moving on to the strength of our balance sheet, we ended the quarter with cash, cash equivalents and restricted cash totaling \$281.7 million. From a cash flow perspective, net cash provided by operating activities totaled \$30.5 million for the 3 months ended November 30, 2022, and net cash used in operating activities totaled \$13.3 million for the same prior-year period. Shifts in working capital generated from changes in our merchandise inventory and accounts payable positions for the 3 months ended November 30, 2022, contributed \$29 million of cash flow compared to the same period the prior year. This positive change was supplemented by another positive change of \$11.3 million in various assets and liabilities, primarily driven by less prepaid VAT and duties as the buildup of inventory was significantly less in the current period comparatively.

Net cash used in investing activities increased by \$9.4 million for the 3 months ended November 30, 2022 compared to the prior year, primarily as a result of a net decrease in proceeds from settlements and short-

term investments. Net cash provided by financing activities during the quarter increased by \$13.5 million, primarily due to the \$16.7 million increase in long-term debt proceeds partially offset by net repayments of \$4.3 million on short-term borrowings compared to the same 3-month period a year ago.

Turning now to our growth drivers, starting with real estate. As we have previously discussed, we currently have 2 warehouse clubs under construction. In the spring we expect to open our third club in El Salvador. Additionally, in the summer we expect to open our second club in Medellin, which will be our 10th warehouse club in Colombia. Once these 2 new clubs are open, we'll be operating 52 warehouse clubs and we are actively exploring additional locations as well. Both of these clubs are applying our smaller-club format and, as we finetune these smaller-club formats we are finding operating efficiencies that we believe will allow us to increase our square footage productivity.

We believe that one of the quickest and most effective ways to increase sales and profitability is to increase the size of our warehouse clubs and the number of parking spaces in our high-volume locations. For instance, we are currently preparing to remodel and expand one of our clubs in San Salvador, El Salvador. As we've mentioned previously, our real estate strategy also focuses on the important role of our distribution facilities to optimize efficiencies and reduce supply chain risk. We continue to actively seek new distribution center options in several of our larger markets to facilitate the frequency and flow of merchandise, maximize selling space in the clubs and create alternatives for e-comm order fulfillment.

Turning now to membership value, one of the things that continues to excite members is the treasure hunt in our stores. Our team of buyers curates items from around the world, seeking out great values on fantastic merchandise. This treasure hunt opportunity drives traffic to our clubs and generates incremental sales opportunities.

An area that we believe provides exceptional value to our members is our private label products under the Members Selection banner. During the first quarter of fiscal year 2023, our private label sales represented 25.9% of our total merchandise sales. That's up 230 basis points from 23.6% in the comparable prior-year period of fiscal year 2022.

Another area of membership value is our wellness offering, which includes optical, audiology and pharmacy. We currently have 47 locations with optical centers and expect to have 51 open by the end of the fiscal year. Our optical program provides for 4 free exams for every membership and we have performed over 33,000 eye exams during the quarter. Optical is also an important social responsibility contributor to our local communities. Through our partnership with Price Philanthropies' Aprender y Crecer program, we have provided approximately 13,000 screenings, 3,500 exams and 3,100 eyeglasses to local schoolchildren since the program's inception and we are very excited about having this service available to support our local communities.

We currently have pharmacy centers in all 8 of our warehouse clubs in Costa Rica and have now opened pharmacies in 2 warehouse clubs in Panama.

With respect to audiology centers, at the end of November 2022 we operated 14 and we expect to open an additional 16 centers in fiscal 2023.

Our third growth driver is our e-commerce channel. During the first quarter total e-comm sales represented 3.9% of total merchandise sales. Total orders increased 8.1% and the average transaction value increased 11.6% versus the prior-year period. So we continue to see encouraging signs with regard to how our members are responding to their online experience with us and PriceSmart.com in general.

As of November 30, 2022, approximately 55.1% of our members have created an online profile with PriceSmart.com. We believe that there are significant growth opportunities in our digital channel. 13.6% of our total membership base has made a purchase on PriceSmart.com. The average online purchase on PriceSmart.com in Q1 was 37.8% higher than the average ticket for in-club purchases. We will continue

to invest in this part of the business in an effort to provide an enhanced omnichannel experience to our members.

It is also encouraging that 8.7% of our membership accounts are involved in our autorenewal option. This membership option allows for a component of our income to become more reliable, which is obviously something that is of great benefit in a climate where we are facing a lot of unpredictable variables that impact our sales.

Now turning to ESG, the Company's actions and practices aim to responsibly use natural resources and focus on environmental impact and social wellbeing. On the last call we told you we were planning to open 30 recycling centers this year and I'm pleased to say our progress has been good as we have opened more collection centers in Guatemala in December and plan to be fully rolled out in that market this month, as well as opening one in El Salvador. To put our impact into perspective, our initial pilot site in our San Pedro Sula club in Honduras averages on a monthly basis about 15,000 pounds of recyclable material.

Additionally, we continue to work with Global Food Banking Network (GFN), where the Company donates non-sellable but safe-to-consume merchandise to participating food banks. We currently have programs in place in Guatemala and Costa Rica that are fully operational, with the intention to begin in El Salvador, Colombia, Panama and Nicaragua over the next few quarters.

To further the philanthropic mission in PriceSmart communities, PriceSmart and the Price Philanthropies Foundation have established the PriceSmart Foundation to serve as the philanthropic partner of our company. The core principles of the PriceSmart Foundation are promoting youth career development and education, supporting economic development in under-resourced communities and funding initiatives that strengthen environmental and community resilience. The Foundation is a separate and independent legal entity from both PriceSmart, Inc. and the Price Philanthropies Foundation and has its own Board of Directors. PriceSmart has budgeted to provide partial funding that includes in-kind donations of staff time and cash grants to nongovernmental organizations that supports its mission and to support the Foundation itself.

Our commitment to sustainability and social causes remains strong and we're committed to fostering a safe, healthy environment for our employees, members, vendors, communities and the world around us that we consider to be part of PriceSmart's family.

Looking forward into Q2, we are happy to report strong holiday sales with our comparable net merchandise sales for the 4 weeks ended January 31, 2023 up 10.4%, which includes a negative currency impact of 0.7%. We also want to highlight that, as disclosed in our 10-Q filed yesterday, we expect to take a charge in Q2 due to the CEO transition, which will reduce EPS by approximately \$0.23.

In closing, I would like to reiterate that we are determined to focus on the fundamentals that have characterized the club business since its inception in 1976, including by ensuring we have the right merchandise, at the right price, in the right quantity, in the right condition, in the right place and at the right time. PriceSmart has a unique business model in the markets where we serve that is embraced by our members and continues to grow.

We have a highly committed and talented team at PriceSmart and I want to thank all of our employees for their continued hard work and dedication to PriceSmart.

With that, I will now turn the call over to the operator to take your questions. Operator, you may now start taking our callers' questions.

Questions & Answers:

Operator: We will now begin the question-and-answer session. [Operator Instructions] Our first question will come from Jon Braatz with Kansas City Capital.

Jon Braatz: Good morning, Robert, Michael. I've got a question for you. Going back to Colombia, obviously it's a very difficult situation. Membership was down sequentially. The comps were weak. In the 10-Q you mentioned that you're considering some different strategies over the near term to confront these issues and one of them was you might hold pricing steady and it could impact the gross margin. I guess two questions.

Number one, have you adopted any new pricing strategies yet in Columbia? And, if so, how far might you go in terms of holding prices and having a little bit of a negative impact on the gross margins?

Robert Price: Jon, this is Robert. And let me begin. I just want to greet everybody on the call, including of course our employees at PriceSmart, who I want to thank for all the good work they do.

We're taking a very serious look at how we want to deal with the sales situation in Columbia. We've got a big investment there. Probably we've put more money into Columbia maybe than any other country we're in, in the real estate. I think now is the time for us to try to build that market. And even though the economy there is weak -- and, of course we also suffer because a lot of our strength is in imports and imports are particularly affected by the currency change. I think we can't be passive. And this is a long road in terms of how we think about Columbia and the future in that country.

And so my -- I don't know the exact numbers, but I would expect that there could be some effect on margins. But we also hope that our suppliers are going to support us in terms of more aggressive pricing, particularly on imports, so that we can begin to build sales volume at this time. So I don't think it's going to be a major thing in terms of margin impact. But I don't -- I think we're going to be more aggressive about how we build sales in Columbia.

Jon Braatz: Okay. Have you implemented anything yet or are you still in the process of thinking about this?

Robert Price: Well, we're doing more -- we haven't implemented anything yet, but we're doing more than thinking.

Jon Braatz: Yes.

Robert Price: We're really actually making plans and working with John Hildebrandt, our new President, and Ana Luisa, who is our Chief Merchant, to try to develop a strategy. We'll do it incrementally. We're going to test things out and make sure that what we do really impacts.

The other thing to keep in mind is we have a second location opening in Medellin. And we want that location to open well, so what we'd like to do is, again, to implement some more aggressive merchandising strategies in advance of that opening.

Jon Braatz: Okay. Secondly, you mentioned that your December comps were up 10.4%, which is a little bit ahead of what they most recently have been last quarter and so on. Did you see a similar improvement in the comps in Columbia in December?

Robert Price: Michael, do you want to answer that?

Michael McCleary: I don't have the Columbia [indiscernible] . . .

Robert Price: I would answer -- I can answer that. I would say in local currency . . .

Jon Braatz: Yes.

Robert Price: . . . yes. But in translated dollars, no.

Jon Braatz: Yes. Okay. That's fair. All right. That's all I have right now. Thank you.

Robert Price: Yes. Thank you for not having more questions. That's good. [Laughter]

Operator: Our next question will come from Hector Maya with Scoti Bank.

Hector Maya: Hi. Thank you very much for the opportunity and also for your time. I wanted to know about the process [indiscernible] over the CEO position. How many [candidates will] it be? How much time do you think it could take and how difficult will it be to find an appropriate candidate to [fill in]? And [is it] more likely that this person would be an outsider to the Company or from within?

Michael McCleary: Hi, Hector. We're having a lot of trouble hearing you. It's coming a little garbled. But I understood your question being related to the CEO transition and I think how long we expect the interim position to last and what the strategy is for replacement? Is it something along those lines?

Hector Maya: Yes. Yes. Thank you. And if it's -- and if you believe it's going to be more likely an outsider to the Company or from within.

Robert Price: Okay. So this is a very, very important question, a very important matter for the Company. And so, what we have been -- our approach is going to be to discuss this with the Board and take our time to be sure we come up with a good answer. Because the Board needs to be involved and this is a key responsibility of the Board, is the leadership of this company. And the resolution of this has to be done in a way that's really got to be good, because it's a very challenging issue to make a transition [of a] CEO. And so we're going to take our time. We're going to make sure we do it right. But it will be a Board responsibility.

Hector Maya: Thank you. And on that note, I also wanted to know [if] long-term strategic [views] for the business could be changing with this [movement] and considering the implications of the appointment of David Price as Executive Vice President and Chief of Staff.

Michael McCleary: Maya, I caught something about David Price and EVP, but I didn't catch the rest of it. I apologize. We're having a lot of trouble.

Hector Maya: Yes. So [indiscernible] long-term strategic views for the business that could be changing considering the appointment of David Price as Executive Vice President and Chief of Staff?

Robert Price: So the question is what is the changes in the business because of appointment of David Price? Is that your question?

Hector Maya: [Indiscernible] -- sorry. I don't know if we can -- let me try something different here.

Robert Price: I'm having a lot of trouble. Let me tell you one thing about David Price.

Hector Maya: [Indiscernible]?

Robert Price: He's my son, you know. And he tells me on a regular basis that I'm too old to understand technology. So he's going to educate me in technology. So that's one thing that I expect from these young people, is they're going to be able to provide much more relevant and knowledgeable information on technology than an old-timer like myself.

Hector Maya: Thank you. I don't know if I heard the answer correctly, because I'm having issues here [indiscernible]. The last question would be an operational question. If you could give us more color on the other [expenses], the categories [indiscernible], mainly on our [FX impact] [indiscernible]. Thank you.

Michael McCleary: Hector, this is -- very sorry, but we're just not -- I heard operational expenses and . . .

Robert Price: Would it be better in Spanish? Do you want to try in Spanish?

Michael McCleary: I just -- no, I think this is a communication line. I think it's more about the communication lines. It's just coming across really terrible. Try one more time, Hector, please.

Hector Maya: So, about the expense [categories,] [mainly] the FX impact, the [indiscernible]. We saw that they were substantial versus historic levels, so wanted to know if you have more details on that.

Michael McCleary: I heard something about FX and something about expenses. Is that the question, about the level of FX expenses below operational income? Is that it?

Hector Maya: Yes. That's [indiscernible].

Michael McCleary: Oh, okay. Yes, good question. The primary component -- the biggest component of that, of the FX line, continues to be the Trinidad FX premiums that we've been talking about for probably 3 years now as being a significant component. The other components actually relate to an unusual circumstance we had this quarter versus other quarters, where we had actually the big appreciation in Costa Rica actually worked against us. You may recall we had some similar circumstances in the past where we have a large dollar balance outstanding, which over time as the Costa Rican colon devalues you would expect that to add more value to us. But, particularly in this quarter, we had a significant 8% devaluation. So that hurt us in Costa Rica. At the same time, we had the known depreciation in Columbia, where we have a liability position. So we did protect -- all of our long-term financing is protected through swaps and local currency loans. But our working capital tends to fluctuate between dollars and local currency.

So we had just kind of a perfect storm there of Trinidad premium, Columbia devaluation, also devaluation in the Dominican Republic, and then the counterintuitive appreciation in Costa Rica kind of all worked against us during the quarter.

Hector Maya: Yes. Thank you very much. I'll try to catch up later [indiscernible] line complications. Thank you.

Operator: We will now take a follow-up from Jon Braatz with Kansas City Capital.

Jon Braatz: Michael, you did a pretty good job on the expense line, the operating expenses. And one of the things you've said in the past is you're going to continue to invest in technology and so on. And did that spending moderate at all in the quarter relative to some prior quarters?

Michael McCleary: No, I wouldn't say it moderated. I mean, obviously -- we've talked about this before -- when sales are going up, then as a percentage of sales . . .

Jon Braatz: Yes.

Michael McCleary: . . . it doesn't distort things as much as when sales are going a little bit slower. But, no I wouldn't -- definitely not say that we've moderated [indiscernible].

Jon Braatz: Okay. So to the extent that revenues grow, let's say, mid-single digit, do you think those expenses -- that expense, technology expense, might grow at a lower rate?

Michael McCleary: I'd say TBD, Jon. I mean, we've got a lot -- Robert alluded to it earlier. We've got a lot to do in the digital area and we've got commitments to continue along that path. And that's the constant thing, our evaluation within Management and within the Board to track and the pace. So lots of things to do and so we'll just -- doing our best to balance that out. But, you know, sometimes it can -- you can get an imbalance as far as the sales growth versus our stated goal to continue down that path.

Jon Braatz: Okay. Thanks much.

Operator: This concludes our question-and-answer session. I would like to turn the conference back over to Michael McCleary for any closing remarks.

Michael McCleary: Okay. Thank you all for joining us today and we look forward to talking to you next quarter. Take care. Bye, bye.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.